

AG Strategies

Agriculture Business Strategies

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The Essentials of Pricing

The purpose of this factsheet series is to help producers and processors understand the key elements needed to manage a business. The factsheets also discuss some of the essential components used to develop a business plan and assess the profitability of a business venture.

You have worked hard to test, develop and package a unique line of products. Now it's time to set prices for all your products. Setting a price for products is a challenging job for both start-up and established businesses. It's an important task since the success of your business relies on your ability to make a profit.

The steps involved for planning the price of your product include components that you also need to develop a business plan. Keep notes and files as you go through each of the steps. By the time you've set a price for your product you'll have information on your customer, your market, your competitors, your costs and your distribution strategy. This information is useful when you write a formal business plan to obtain financing.

To set the best price for your product you need to review the essentials of your business with an eye to how they affect price.

Essential steps to planning your product's price are to:

- know your customer
- identify substitutions
- determine the cost of production
- develop and cost a marketing plan
- design and cost a distribution strategy
- research product pricing methods

The customer is an essential element of your business. Take the time to design a target customer profile. Search for all the substitutes your customer could switch to and keep an up-to-date list of them. Do you know how much it costs to make your product(s)? Prices must go beyond break-even to include a profit. Design your marketing plan to ensure your target customer knows about your product. Select a distribution plan that efficiently connects your product with the customer. An understanding of pricing methods and how they can be used provides more pricing options.

Know your customer

The better you understand the wants, needs, beliefs and values of your customer, the easier it is to accurately price your product. A target customer profile is an important first step in pricing.

A target customer is the person who buys your product and is likely to make repeat purchases. The type of target customer you define depends upon your product. You may decide to attract a broad customer base with general characteristics or a narrow target group with unique factors.

To define your target market you must understand where the customer lives, their age, education, family size, spending patterns, leisure habits and needs. To prepare a target customer profile, include as much detail

as you can. You will need to conduct market research to fully define target customer characteristics.

Market research can be done using two different methods: primary data and secondary data. Primary data uses detailed methods to provide tailored information about the wants and values of your customers. It's usually expensive as most business owners find they must hire a market research professional to design the research method and to interpret the data.

Secondary data is compiled from existing materials and research. It's more general, but can often give you the insight you need about the industry, key contacts and customer characteristics. Most business owners find they can conduct their own secondary data research.

Example:

A farmers' market vendor can use a recent study entitled, *Farmers' Markets in Alberta – A Direct Channel of Distribution* to profile a target customer. After reading the study, the vendor knows the target customer is a 25 to 46-year-old female. The target customer is loyal to the market and visits it regularly to buy vegetables, baked goods and meat products. Many customers visit a specific vendor each time. The wants of this target customer are freshness, product quality and to support local farmers and the community. You can gather your own primary data by booking a stall at the farmers' market for a month or two. Use this time as an opportunity to talk to your potential customers. Ask about what's important to them, prices, why they shop at the market, etc.

Identify substitutions

The number of substitutions available on the market and their price must be considered before you set your product price. Substitutions are similar products for sale in the marketplace. Your target customer may decide to switch to a similar product or substitute if they believe your product no longer offers value.

Example:

If you plan to grow carrots and market them through several farmers' markets you should scout these markets and prepare a list of other vegetables or substitutions available for sale. Be sure your list of substitutes is complete. A list of substitutions for carrots could include corn, peas, parsnips, beans and a number of other vegetables that could be used as cooked vegetables. If your carrots are used in salads, other vegetables could be used instead. Remember, if people want carrots, they

buy carrots. If you process a specialty product like birch syrup, all other pancake syrups are considered substitutes.

Determine cost of production

To calculate your cost of production, follow these three steps. First, you need to know how much it costs to make the product. To do this you need accurate, detailed bookkeeping records. Second, you must know how much you produce throughout the year. Detailed inventory records provide this information. Third, you need to calculate a per unit cost. Use cost and output numbers to calculate a per unit cost. If you plan to use seasonal pricing, then calculate various per unit costs for the periods in the year when prices are bound to change. If you are the first at the start of the season to have new potatoes for sale, you can charge a premium for your product. Your target customer is likely willing to pay extra for the freshness and quality.

People planning a start-up business need to research the costs of inputs, labor and equipment. You need to project how much you plan to produce. If you operate a business where production varies throughout the year, be sure to project output on a monthly basis. A per unit cost estimate can be projected using cost estimates and output projections.

Develop and cost a marketing plan

Marketing costs must be calculated on a per unit basis and included in the product cost.

There are many ways to promote your product to target customers. The amount and types of marketing you decide to use can range from word of mouth to hiring a marketing firm that manages all aspects of an intensive marketing strategy. This means the cost of your marketing efforts can range from low to a substantial percentage of your costs.

To develop a marketing plan you need to set marketing objectives, describe your target customer and select a marketing mix. The marketing mix is often called the four Ps of marketing. They are price, product, promotion and place, or the distribution channels.

To prepare a marketing plan you need to research the various promotion methods available. This can be done by talking to other business owners, conducting a secondary research study on promotion methods and

through interviewing firms that develop and manage promotion campaigns. The type of promotion you select should be based on your marketing objectives, the types of competition you face, the cost of marketing activities and how you plan to manage the other three Ps in the marketing mix.

The marketing plan should extend beyond the immediate year to include how you will market the product(s) for the next three to five years. A longer term plan is important if you plan to expand the promotion plan to grow your customer base. New businesses often use little or no promotion when they start-up because they can't afford it. When you can afford it, promotion can be used to further refine your target market or create new markets.

Research the costs of your promotion strategy now and in the future. Calculate marketing costs on a per unit basis. Include promotion costs in your product price.

Design and cost a distribution strategy

This step answers the question: How will I get my product or service to my target customer? The short answer to this question is to select the right channel(s) of distribution based on your product, customer and competition.

A channel of distribution links your product with your target customer. There are many types of market channels. They range from the use of a local farmer's markets to selling directly to customers. Selling your product to a broker who takes responsibility for sales to customers is another option.

Market channels give you plenty of flexibility. You can select one market channel or combine several into a distribution strategy. Many new business owners keep start-up costs low by taking responsibility for product distribution. As the business grows you may decide to use several distribution channels to reach different customer groups. Like marketing and production, you need to research your distribution costs and calculate a per unit cost. Add the per unit distribution cost to other product costs.

Research product pricing methods

This step helps you find an existing pricing method or design a pricing strategy to suit your business. The three types of pricing strategies are cost-based pricing, competitive based pricing and customer based pricing. Each offers several choices in how you can set your price. Product pricing methods are explained in detail in the factsheet, *Methods to Price your Product*.

Product pricing is a big decision for any business owner. The right product price can earn the profit you desire, draw target customers and support your promotions plan. Incorrect product prices can wipe-out profit, annoy customers and hurt your reputation in the market.

A decision with this much impact on your business deserves extra attention. Take the time to detail your target customer, research current substitutes and maintain cost of production records. Decisions on how you market and distribute your product affect which pricing method you select.

For more information on pricing value-added products contact –

- Rural Development Specialist – Business
- Agri-Food Development Specialist
- Agricultural Business Management Branch
- Business and Diversification Centres

Additional factsheets on related topics include:

- Market Research...The Basics
- Market Research...The How to
- Market Research...When to Hire a Professional
- Market Research...Help and Where to Find It
- Methods to Price Your Product
- Pricing Horticulture Products
- Pricing Processed Food Products
- Market Guide for Food Processors

Glossary

Broad customer base – a large number of customers with more general characteristics.

Distribution channel/market channel – describes the methods you use to get your product from your production facility to the end-user

Marketing mix – a term used to describe the four Ps of marketing. The four Ps are price, product, promotion and place or distribution channels.

Narrow customer base – a smaller customer base with unique characteristics.

Primary data - detailed research methods such as interviews or actual buying patterns to provide tailored information about the wants and values of your customers.

Secondary data – information from existing materials that tends to provide general details on your industry, key contacts and customer characteristics.

Substitutions – the same or similar products to the product you are selling to customers.

Start-up – a stage in a new business where the owner(s) is planning for the production, marketing, distribution and pricing of the product.

Target Customers – the people who buy your product and are most likely to continue buying the product.

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